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# Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

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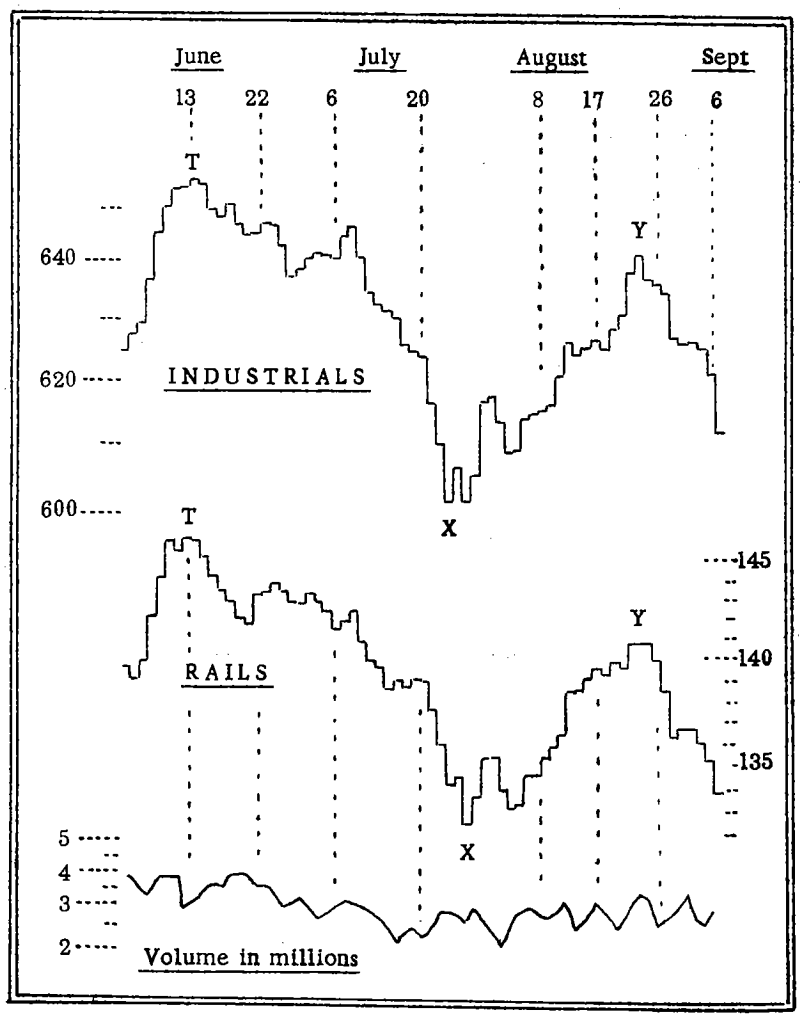
PRICE MOVEMENTS In Letter 115 I wrote that if the Y peaks were to be approached or "tested", I would expect the decline from Y to correct no more than 1/3 to 1/2 of the gains established on the X-Y rally. As of this date (Sept. 8) the decline from Y has erased a good deal more than 50% of the X-Y advance. This can hardly be construed as bullish. If the Averages again approach the X lows I believe that the odds favor a penetration. So far, investors have refused to sell stocks on each close approach to the 600 level. Yet it will take just such selling (with a resultant breaking of the 599.10 Industrial low) to reconfirm the primary bear market.

SEPTEMBER SONG Since 1929 there have been nine years in which bear markets were in effect during all or at least the second half of the year. Of these nine periods, five provided poor September markets. In a sixth (1946) the market hit a rally high in August and bottomed in mid-September. All of which suggests that September tends to be a "down month" during bear markets. Traditionally, the post-Labor Day or early September period is the one in which investors appraise the possibilities of fall and winter business. If the forthcoming business picture is seen to be unsatisfactory, stocks will move down to discount that fact.

With this seasonal tendency in mind, it will be particularly interesting to see whether the Averages can hold above their bear market lows (Industrials 599.10, Rails 132.37) during the coming month or so. Since Rails have already broken a series of preceding lows, the more important indicator is now the Industrial Average.

It is well to remember that today's disappointing news has already been fully discounted by the market. Therefore, if the Averages can manage to hold above the bear market lows it is possible that we will have at least a seasonal business rise this fall and winter. On the other hand, if the Averages violate the lows we can be sure that they are discounting adverse news which will not be apparent for days, weeks or even months to come.




TECHNICIANS In glancing over a number of leading technical services I note that the large majority of them are now either bullish or turning bullish. They base their optimism on (1) the bullish odd-lot ratios, (2) the July increase in the short position, (3) the improved "breadth of the market" (advance-decline ratio), (4) the "triple bottom" in the Industrial Average,

(5) the diminishing number of new lows at each new approach to 599.10, (6) the new recovery high of 84.4 in Barron's Confidence Index,

Against this we have the long-term implications of the Dow Theory bear signal and the numerous "top characteristics" which have appeared since early 1959.

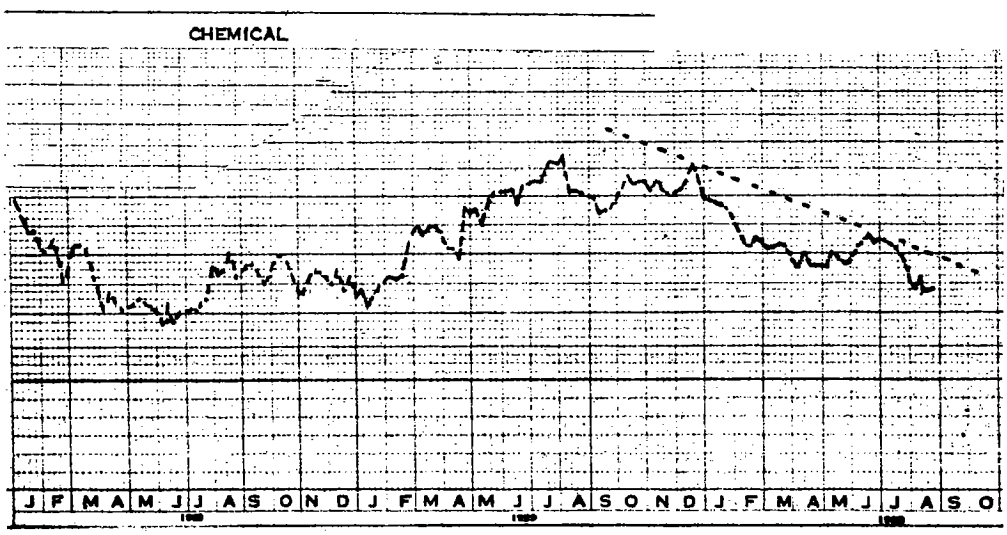
The current situation is most interesting when contrasted with the situation which prevailed three years ago. In July, 1957, the Averages reacted sharply, and the reaction bottomed out in October of that year. The market then entered upon a long, relentless advance. Business conditions continued to worsen into April, 1958, however, and the great majority of economists (refusing to believe the Averages or the market's technical position) chose to remain bearish simply because the business news was bearish. History shows, of course, that the economists were wrong.

Now we have another case of the business news' deteriorating, but this time the nation has "smartened up". Economists and financial writers are now scrutinizing the stock market, and they note that the "600 level" is holding. The Dow Theory bear signal implied that the top had been seen and that the trend was down. But, say the economists, the bear signal must have been meaningless because the Industrial Average has refused to "fall apart". The same people who were fooled in 1957-58 are telling themselves that they "are not going to get fooled this time".

The news coverage of the market's current "technical position" is positively amazing. Even Time Magazine (September 5, 1960) in a business article entitled "Wall Street -- Ready to Move Up", draws the attention of its millions of readers to the market's technical condition: "Last week the market's technical position looked stronger to the analysts than it has in more than a year." And again Time ventures, "With the big insititutional investors now returning to the market and the market's basic psychology improving, many Wall Streeters believe that the market is ready to respond to favorable news, take off on a sustained advance to new highs."

This writer wonders, in view of all the attention now being focused on the "tehcnical position", whether the market is not getting ready to play another one of its ironical little tricks.

RELATIVE STRENGTH The chart below shows the continuing deterioration in the relative strength of the chemical group. Relative strength is derived by comparing price action of an individual group to the price action of the entire market as measured in this case by Standard & Poor's "500" Average. It is a characteristic of relative strength that once a pronounced trend is established, that trend continues for extended periods of time.

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